OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

October 27, 1983

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(With Confidential Attachment)

MEMORANDUM FOR	OVP	- MR. PHILIP HUGHES
	STATE	- MR. CHARLES HILL
	DEFENSE	- COL. JOHN STANFORD
	INTERIOR	- MR. BARRY ALLBRIGHT
	AGRICULTURE	- MR. RAYMOND LETT
	COMMERCE	- MRS. HELEN ROBBINS
	OMB	- MR. ALTON G. KEEL
	CIA	- 25X1
	USTR	- MR. DENNIS WHITFIELD
	GSA	- MS. JOSEPHINE GOOD
	OCA	- MR. THOMAS GIBSON
	OPD	- MR. LES DENEND
	NSC	- MR. ROBERT KIMMITT
	CEA	- MR. WILLIAM A. NISKANEN
	FEMA	- MR. BERNARD McGUIRE

Subject: IG-IEP Paper on Government Barter Policy

Attached is a revised options paper on U.S. Government barter policy, incorporating the comments and suggestions made after the October 19 IG-IEP meeting. We expect to circulate the IG-IEP recommendations to the SIG-IEP on Monday for consideration at its next meeting. Please phone any additional comments and your agency position to Mr. Cornell (566-2748) or Mr. Gale (566-2561) by 4 p.m. Friday, October 28.

This review has been extremely constructive and will certainly lead to a more rational government policy and review procedure for examining future barter proposals. Bob Cornell wishes to express his appreciation to all participating agencies for prompt attention and frank discussion of all factors in this issue.

David E. Pickford
David E. Pickford
Executive Secretary

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IG-IEP OPTIONS PAPER

U.S. Government Barter Policy

Executive Summary

I. Issue and Sources of Pressure

The USG's trading for its own account involves, primarily, sales of CCC-owned agricultural commodities and both sales and acquisitions of materials for the National Defense Stockpile. In the current international trading environment, barter proposals have become popular, and a few *ad hoc* government barter transactions involving Jamaican bauxite have already been concluded. Proponents of barter deals represent the agricultural community (disposal of CCC surpluses), national defense community (restructure of the stockpile), and certain LDCs facing foreign exchange shortages. Also, considerable pressure is building in Congress to formalize further the policy on government barters.

II. Policy Issues and Conflicts

The Administration generally is opposed to barter, but occasionally such deals are in the U.S. national interest. In deciding on particular barter proposals, policy conflicts can arise and we currently lack specific guidelines in addressing such conflicts. The policy concerns needing examination include:

-- consistency with existing legislation, including trade law;

-- consistency with U.S. international obligations;

-- basic U.S. trade and commercial policy;

-- political factors;

-- consistency with stockpile goals and priorities;

-- consistency with agricultural policies and objectives;

-- broader economic issues such as international debt problems facing many LDCs; and

-- consistency with budget levels.

III. Policy Options

Administration consideration of the various policy issues can be handled in several ways and several options have been proposed:

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1. -- oppose all barter deals

2. -- maintain the present ad hoc arrangement

3. -- support or introduce new legislation

4. -- provide for formal review of each proposal according to a set of guidelines to help determine whether a particular transaction is in the national interest

Most agencies favor Option 4 or some variant, which includes a set of policy criteria which would need to be addressed by the agency proposing a barter deal. This procedure would be consistent with our trade policy stance of discouraging barter. For particular deals, however, it would ensure that the major policy impacts would be formally reviewed, that the barter proposal is clearly in the national interest, and that it provides benefits not obtainable from normal cash transactions. This option would still preserve the Administration's flexibility in deciding individual proposals.

Several interagency fora have an interest in barter programs including:

1. The Annual Materials Plan Steering Committee (AMPSC)

2. The Emergency Mobilization Preparedness Board (EMPB)

3. The Cabinet Council on Natural Resources and the Environment (CCNRE)

4. The Trade Policy Committee (TPC)

5. The Senior Interagency Group on International Economic Policy (SIG-IEP)

The SIG-IEP seems to have a membership that represents the major policy areas with barter interests -- economic, foreign policy, and national security -- and it could receive input from other groups as appropriate.

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IG-IEP Options Paper

U.S. Government Barter Policy

I. Issue

The USG plays a substantial role in international commodities trade for its own account. Its trading involves, primarily, sales of CCC-owned agricultural commodities and both sales and acquisitions of materials for the National Defense Stockpile. In the current international trading environment, various kinds of barter and countertrade techniques have become increasingly popular, and pressures have mounted -- from both inside and outside the Government -- to employ barter in one form or another in the Administration's own official trading activities. A few ad hoc barter transactions have already been arranged; they have highlighted (1) policy conflicts that can arise as different USG programs are affected, and (2) the lack of detailed policy guidelines on barter transactions. The IG-IEP has been asked to consider the issues and develop a decision memorandum for the SIG-IEP (see Tab A).

II. Essential Factors

A. Scope of the IG-IEP Review

The Trade Policy Committee directed an interagency staff group to examine the full range of "countertrade" issues, including barter, and to recommend policy options as appropriate. A TPSC paper, "Countertrade and Barter", has been approved and transmitted to the interested agencies by the TPRG (TPSC Document 83-93). In its recommendations the only reference to official barter arrangements was that the U.S. Government exercise caution in the use of its barter authority, limiting it to situations where it can offer advantages over conventional market operations. The U.S. Government also would be directed to undertake initiatives in several international fora and in bilateral discussions to discourage or circumscribe countertrade.

This recommendation, which is consistent with earlier language agreed to by the SIG-IEP, provides overall policy guidance. Because of the number of barter proposals made recently, however, the SIG-IEP should consider the content of additional operational guidelines. Consequently, this paper will focus only on the Government's policy of when and how it should use barter. The broader issue of policy on countertrade will remain in the TPC framework.

B. Sources of initiatives and pressures for more USG barter transactions

Impetus towards barter arises from several sources within the Administration, Congress, other governments, and private traders, specifically:

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Declassification on 9/89

-- The Stockpiling Act of 1979 directed the President to use barter when it is in the best interest of the United States;

-- In May 1981 the President directed that restructuring of the strategic stockpile get underway;

-- USDA was instructed by the President in 1982 to examine barter opportunities as means of using the large quantities of CCC stocks to help acquire materials for the stockpile;

-- There are several initiatives on the Hill to legislate that stockpile barter be undertaken on a continuing basis (see Tab B for legislation and scheduled hearings);

-- The Senate Republican Policy Committee has circulated a paper which favors more aggressive barter of CCC commodities and strategic materials as a tool to promote foreign trade;

-- There have been proposals urging that the Administration barter nonfat dry milk in CCC stocks for Mexican fluorspar;

-- In 1982 the President agreed to several barter deals with Jamaica;

-- Some other nations which export industrial commodities -- for example, Zaire, Kenya, Indonesia, and Mexico -- have approached agencies indicating a willingness to barter.

C. <u>Sources of policy conflict</u>

Actual and potential barter transactions cut across or otherwise cause an impact upon programs, policy objectives, or existing policies in several areas. These multiple impacts often reveal policy conflicts that either require some policy objectives to be subordinated to others or put the USG in a position of looking the other way when a transaction undertaken for some overriding reason causes a strong policy position in another area to be compromised. Among the issues in this regard are (1) Consistency with existing legislation, including trade law; (2) consistency with U.S. international obligations; (3) basic U.S. trade and commercial policy; (4) political factors; (5) consistency with stockpile goals and priorities; (6) consistency with USDA policies and objectives; (7) broader economic issues such as the international debt problems facing many LDCs, and (8) consistency with budget plans.

Existing law

Stockpile law. The Strategic and Critical Materials Stock Piling Act (50 U.S.C.; 98 et. seq.) is specific about the purposes of the stockpile. In discussing the contents, disposals and acquisitions of the stockpile, and how the President shall make these determinations, the Act says, in relevant part:

> The purpose of the stockpile is to serve the interest of national defense only and is not to be used for economic or budgetary purposes. [SEC. 98b(b)]
>
> The President shall encourage the use of barter... when acquisition or disposal by barter is authorized by law and is practical and in the best interest of the United States. [SEC. 98e(c)(1)]
>
> Materials in the stockpile, the disposition of which is authorized by law, shall be available for transfer at fair market value as payment for... acquisition of materials... [SEC. 98e(c)(2)]

One legal interpretation of the fair market value stipulation in the Stock Piling Act has concluded that Congress' intent was to ensure that the stockpile is used for purposes of national defense only and to discourage its use for other purposes.

To the extent that a particular barter transaction benefits the foreign exchange reserves or balance of payments situation of a foreign country and the effective price charged that country for the commodity delivered to it out of the strategic stockpile is less than fair market value, this may constitute an economic use of the stockpile for the primary benefit of another government. While the transaction may be in the best interest of the United States since it permits the strategic stockpile to acquire a needed material, the same benefit might accrue to the United States if the transaction could have been made at fair market value. If a subsidy element is a necessary part of the transaction, it may violate legislative constraints on stockpile disposals. (See Tab C for background on stockpile management and organization).

CCC law. The Department of Agriculture (USDA) through its Commodity Credit Corporation (CCC) has legislative authority to barter surplus commodities from CCC stocks, as well as from the National Defense Strategic Stockpile, for other materials which are needed in the Strategic Stockpile. (Section 4(h) of the CCC Barter Act and Section 310 of P.L. 480 7 U.S.C section 1692.) The barter authority for CCC is generally considered to be a tool for disposing of surplus agricultural inventories while GSA's authority is a tool for managing the changing composition of the Strategic Stockpiles. The CCC acquired barter authority in 1949, while GSA has been using barter since the early 1950's.

The U.S. Barter Program, as operated under Public Law 480 (P.L.-480) from 1954 to 1962, was primarily used to exchange CCC-owned agricultural commodities for strategic materials. Starting in 1963, P.L.-480 barters for strategic materials were curtailed and the U.S. Barter Program was used primarily to procure foreign-produced supplies and services used in construction projects for the Department of Defense and in projects of the Agency for International Development under the authority of the CCC Charter Act. The Barter Program was suspended in 1973 when CCC stocks were largely depleted and the supply of private stocks no longer justified the need for a barter program). A second kind of legislative authority, written into the Foreign Assistance Act of 1974, gives the President power to barter foreign assistance and services for strategic materials. No President has used this power.

International trade considerations

Domestic Trade Laws. Strategic materials purchased for the national stockpile, if acquired at dumped or subsidized prices, could be liable for antidumping or countervailing duties. However, depending upon the share of imports represented by the barter transaction, the degree of subsidization/dumping of imports may be *de minimis* and would not precipitate a complaint.

The fact that the Government is the importer in this case makes no difference under U.S. laws. However, U.S. Government agencies can request Customs to waive duties on the import of goods they purchase. Such a waiver could include waiving any assessed countervailing or dumping duties.

GATT Subsidies Code. Under the GATT subsidies code, the U.S. is obligated not to subsidize agricultural exports in a manner that takes more than an equitable share of world markets or results in material price undercutting. The barter of CCC commodities would likely entail government subsidies to permit the sale below acquisition prices. Other governments could be expected to complain if the barter involved a substantial quantity of CCC commodities which would increase the U.S. share of the world market for that commodity as compared to a recent representative period (usually three years).

U.S. Commercial policy

Distortion of Commercial Markets. Past experience with CCC barter programs revealed the difficulty of assuring that barter exports do not displace normal commercial sales. The frequent price discounts involved in barter also encouraged price-cutting by other exporting countries, resulting in market disruptions.

Economic Efficiency. The barter of CCC stocks for strategic materials may be beneficial in budget terms if it is the most efficient way of obtaining priority materials which we would otherwise be purchasing anyway, if the carrying costs of the CCC stocks exceed the storage costs for the acquired strategic materials, and if the Government is bound to take a loss on the CCC stocks in any event (i.e., the cost of acquisition cannot be recaptured and the value of the stocks is likely to decline over time).

Barter generally tends to be less efficient than purchases on the open market for cash, entailing some "loss" on either the import or the export side (through implicit export subsidies or higher cost of the acquired good). Unless the goods are traded in the same proportion as a commercial cash transaction, then one partner gains at the expense of the other.

Determining the efficiency of a barter transaction normally would include looking at:

-- the cost of acquisition of the CCC commodity and/or its current market value relative to the imputed barter price (the first comparison will provide the amount of government subsidy or "loss" on the export from the time of acquisition, while the second shows the subsidy or profit compared to market prices);

-- the purchase price of the strategic material relative to world market prices or the least cost supplier;

-- the carrying costs (interest and storage) of both commodities;

-- the priority of the purchase;

-- the feasibility of correcting the market distortion that may have caused the accumulation of government-owned stocks (e.g., high support prices).

The recent Jamaican bauxite swaps illustrate some elements of the economic inefficiencies which can arise from barter.

There have been three Jamaican bauxite transasctions in the last two years. Two of these involved barter. The most recent deal swapped dairy products held by USDA/Commodity Credit Corporation for 1 million tons of bauxite. Since CCC is prohibited from transferring its assets without reimbursement, CCC will hold title to the bauxite until 1988, when GSA will begin a three-year purchase program from USDA. Bauxite had a relatively high priority within the stockpile but lower than for other commodities planned for acquisition in 1983-84. The rationale for the deal is to support the current government in Jamaica; the U.S. stands to gain materials for the stockpile for dry milk which is not salable on the world market at present U.S. prices. However, the U.S. Government may spend more to ship (in U.S. bottoms) and store the bauxite (until taking title) than the Jamaican Government will realize from the trade. Further, the bauxite barters brought pressure on the State Department for similar preferential treatment by the Governments of Haiti and Brazil.

Budget Policy Considerations

Barter arrangements are not tied to appropriations and go beyond program levels established in the President's budget, so bartering can become a "backdoor" method of financing other program objectives not envisioned by the President's budget. Whether the deal results in spending more than appropriated levels or whether a barter results in the least cost way to solve a problem is seldom considered. Consequently, bartering ends up distorting funding priorities which may increase the current deficit.

The ferroalloys upgrading program is an illustration of the kind of budget distortions which can occur from barters. Following a section 232 trade investigation, the President directed the upgrading of manganese and chromite in the stockpile to their ferroalloy forms. Since stockpile rules prohibit the use of the Transaction Fund to upgrade materials, a "materials exchange" (or barter) approach was adopted. In this case, tin will be sold and the receipts earmarked to support the cost of upgrading. At last estimate, roughly $40 million of tin would be sold in each of the next ten years to the ferroalloys program. This deal resulted from a Section 232 investigation that determined a national security need to protect this industry. It will result in stockpile acquisitions beyond those in the budget.

Political considerations

The Government's consideration of barter proposals usually must take into account three sets of political interests: (1) the farm community's interest in surplus disposal, (2) the U.S. mining industry's interest in having first right of supplying materials to the stockpile, and (3) the interest of developing countries in obtaining U.S. surplus food for their raw materials without using up scarce foreign exchange.

The farm community has often been the leader in efforts to use barter. Although the ultimate objective is surplus disposal, proposals are usually framed as a package deal whereby surpluses are being exchanged for needed raw materials with the U.S. Government gaining a double benefit. When CCC runs out of surplus commodities or GSA needs no more raw materials, barter proposals disappear.

The U.S. mining industry has been less vocal on barter, but nevertheless is vigilant that acquisition of foreign source materials does not displace potential domestic sales. In many cases the U.S. is wholly dependent, or nearly so, on foreign supplies, so no conflict with domestic miners occurs. But if a proposal were made to barter CCC commodities for copper, then the U.S. copper industry would be heard from -- early and loudly.

Foreign political interests can cover a wide range -- from a simple good-will gesture of providing surplus food for token raw materials to a major effort to relieve a food import shortage caused by lack of hard currency due to weak international markets for the country's industrial commodities. For such an operation to provide benefits to the foreign country which it could not obtain in a normal cash sale, either the implicit prices at which the goods are bartered must value the commodities higher than the international market does, or the transaction would have to function as a food-aid deal not otherwise feasible within our budget process.

USDA and GSA policies

Conflicts between USDA and GSA can arise because USDA objectives focus on surplus disposal or market promotion while GSA objectives focus on acquiring materials for the stockpile according to an established priority list. Since the customers for USDA's excess commodities rarely mesh exactly with sources of strategic materials on GSA's highest priority list, GSA is often asked to accept lower priority materials in order to close a deal. This can have a double impact on the stockpile restructuring process when, as is usual, USDA insists on a cash payment (transfer) from the Stockpile Transaction Fund to compensate it for the barter "sale" of surplus farm products. GSA thus gives up cash earmarked for high-priority stockpile acquisitions.

Broader issues

The Government often has to address broader implications of decisions on whether to undertake a particular barter arrangement. For example the enormous CCC inventories of dairy products are costing several hundred million dollars a year in storage and interest costs and the possibility of recovering those costs through future sales is small. Thus, a barter arrangement could result in the GSA acquiring inventories of strategic materials at little or no cost to the Government; in fact there might be a net saving in storage costs. CCC will, however, have to recover the value of its inventory loss through appropriation -- either through a restoration by Congress of borrowing authority or by reimbursement from GSA's stockpile transaction fund. These short term cost savings, however, may promote delay in reforming the highly costly dairy support program, thus leading to even larger outlays over the long term.

Also, there is the question of whether a particular barter program may significantly aid a country's efforts in coping with its debt problems. If so, then an arrangement to bridge a difficult period may help prevent a disruption of financial markets at very little cost to the U.S. Government.

A further danger of undertaking many barter arrangements for strategic stockpiles is that extensive GSA reimbursement commitments may reduce its future flexibility in restructuring of the stockpiles.

Finally, there is the danger that several Government-to-Government barter deals will strengthen the tendency for foreign countries to require barter or countertrade deals, thereby frustrating the overall policy goal of discouraging countries from requiring such arrangements which we believe detract from the efficiency of the international trading system.

Organization

Presently, one agency can initiate and move a barter proposal forward almost to the point of a commitment, without the adequate interagency review. Other affected agencies may be placed in the position of accepting a 'fait-accompli' without suitable ventilation of their views and full discussion of the proposal's impacts on their programs' objectives. In other words, a proposing agency can advance its goals through a barter arrangement without realizing (or caring) it could be adversely affecting another agency's mission.

III. Policy Options

In deciding on the appropriate Administration stance with respect to barter, the SIG-IEP may want to consider the following four options:

A. Oppose all barter deals.

B. Maintain the present ad hoc procedure of deciding each proposal on the basis of benefits to the U.S., justifying an exception to a general policy of opposition.

C. Support or introduce legislation that clarifies when barter is to be used and provides for any additional authority which is necessary.

D. Adopt a set of internal guidelines developed by the IG-IEP, intended to help determine whether a particular transaction is "in the national interest," and provide benefits not obtainable from a normal cash transaction. Those guidelines would include:

1. All barter proposals are to be examined by the IG-IEP and implemented only after approved.

2. The initiating agency in preparing the proposal must address the following questions:

a. Is it consistent with adjustment programs imposed by the IMF?

b. Do the exported U.S. commodities replace cash sales by the U.S. or competitors?

c. Is world trade for the strategic material augmented, and is there avoidance of market disruption?

d. How does it affect the U.S. balance of payments?

e. Is it consistent with U.S. trade law and policy and our adherence to international obligations?

f. Is it consistent with the President's approved budget spending levels?

g. Is it consistent with strategic stockpile or CCC statutes?

h. Is is consistent with the annual materials plan for stockpile disposals and acquisitions?

i. Is it the least-cost method of meeting our international political objectives?

j. What are the economic efficiencies of the barter compared to a cash transaction for the material (s) to be acquired and bartered?

k. To what extent are U.S. National Security interests advanced?

3. If the IG-IEP cannot agree on disposition of the proposal, it will be referred to the SIG.

Discussion

Blanket opposition to barter (option A) would be most consistent with the U.S. free market philosophy and the commitment to a trading system less encumbered by inflexible bilateral arrangements, and to ensuring that approved spending levels are not exceeded. Such a policy also would simplify the operational and budgetary considerations in managing the CCC and strategic stockpile programs. Further, it removes the temptation to use barter as a disposal mechanism for CCC surpluses. On the other hand, strict opposition to barter proposals may be an excessively rigid policy which could prevent the Government from engaging in such arrangements when they are clearly beneficial to the U.S. on economic or political grounds. In addition, such inflexibility could be taken by the farm community, Congress, and interested developing countries as insensitiveness to the difficult problems facing various sectors and countries.

Continuing with the present ad hoc policy (option B) is the easiest course but it would likely result in a hit or miss pattern of barter deals which would waste resources, result in spending beyond approved levels, contribute little to the U.S. policy objectives, cut down GSA management flexibility, undercut our overall countertrade policy, and ultimately lead to abuse. Some people would argue that there have been very few barter deals to date and that the few that will be proposed in the future can easily be handled on an ad hoc basis. It also is a logical approach to consideration of highly complex cases where guidelines can't adequately take into account all the conflicting economic, budgetary, trade policy, foreign policy, farm policy, and strategic stockpile aspects of each proposal. As a safeguard against abuse any highly controversial proposals could be referred to the SIG-IEP for approval.

The third option, to support or introduce legislation, would elicit a very positive response from Congress and could preempt undesirable bills now in the mill. The large number of bills that have been introduced and the paper by the Senate Republican Policy Committee attest to the widespread interest in this issue. In addition, some strong supporters of stockpile restructuring have been dismayed by the difficulty in appropriating funds for acquisitions. To them, a promising strategy is to negotiate some barter arrangements for strategic materials now when markets are weak and let CCC hold an IOU until GSA can muster the funds for reimbusement, or to eliminate the reimbursement provision. The chief arguments against this option are: (1) that adequate authority already exists to barter either CCC commodities or GSA surpluses for materials to be included in the stockpile; (2) new laws are likely to reduce the Administration's flexibility in managing all three programs -- farm, stockpile, and barter programs -- and, 3) such arrangements usually result in approved spending levels being exceeded.

The main advantage of option D, adoption of guidelines, is that it gives the Administration the opportunity to announce a specific policy on an important subject, while reserving flexibility in implementing it. The proposed guidelines do not go significantly beyond sound procedures which should already be in force, but they would be generally known, so that all parties -- U.S. agencies, foreign trading partners, and interested U.S. groups -- will understand the general criteria for viable barter proposals. It would be fully consistent with the TPSC recommendations in the countertrade paper. The main disadvantage of this option is that it raises the visibility of barter, and will likely encourage additional proposals which meet the criteria, making it more difficult to turn them down. Some agencies are particularly concerned about this disadvantage and propose SIG review of proposals on an ad hoc basis without specific criteria. The advantage of this suboption is that it would provide an incubation period for using the SIG-IEP as a basis for drawing up a set of guidelines.

A proposal also has been made that a combination of options C and D would permit the Administration to address the concerns of Congressman Bennett and others in Congress while retaining flexibility in reviewing barter proposals.

IV. Implementation and Interagency Fora

A number of existing interagency fora are involved with barter based on legislative or executive order mandates. Briefly, the fora and their authorities are:

-- Annual Materials Plan Steering Committee (AMPSC) of the National Defense Stockpile

-- Emergency Mobilization Prepardeness Board (EMPB)

-- Cabinet Council on Natural Resources and the Environment (CCNRE)

-- Trade Policy Committee (TPC)

-- Senior Interagency Group on International Economic Policy (SIG-IEP)

AMPSC. This body, chaired by FEMA, takes its authority from Executive Order 12155 and indirectly through the 1979 Stock Piling Act. It reviews and can originate stockpile barter proposals to aid in the restructure of the National Defense Stockpile. Thus, it focuses only on barter proposals directly affecting the National Defense Stockpile, and has no authority over government barters concerned with other government programs. Following its review of a stockpile barter proposal, the committee forwards its recommendation to the Director of FEMA for disposition.

EMPB. This board takes its authority from the National Security Decision Directive on Emergency Mobilization Preparedness (NSDD-47), and is chaired by the Assistant to the President for National Security Affairs. Its mandates are broad and encompass all sectors of society and government services which may affect national preparedness for emergencies, but they do not specifically identify the national defense stockpile or stockpile barter as uniquely under its jurisdiction.

CCNRE. This Council, chaired by the Secretary of Interior, is charged by the Administration's National Materials and Minerals Program Statement of 1982 with the task of coordinating national materials policy. It relies for detailed analyses on the various agencies and departments which have ultimate statutory responsibility for implementing specific programs. The statement says about barter: "Two additional mechanisms, exchange and barter, are authorized for acquiring material for the stockpile. The Administration will seek cases where these are more efficient and effective mechanisms than open market transactions"; it cited the first Jamaican bauxite cash-barter transaction as illustrative of use of such mechanisms.

TPC. This Cabinet-level interagency organization, chaired by the U.S. Special Trade Representative (USTR), was created by the Trade Expansion Act of 1962. It assists the President in carrying out the trade policy function assigned to him by the same Act. It is responsible for advising the President on basic policy issues arising from the trade agreement program, and making recommendations with respect to tariff adjustment issues and foreign trade restrictions. Generally, its composition is of departments directly concerned with trade policy issues. Only rarely does it concern itself with barter matters and stockpile policy and management.

SIG-IEP. This cabinet-level interagency group was created by the National Security Council to provide framework for discussing the international economic implications of various foreign policy or national security issues. The Secretary of the Treasury chairs the group whose members include all economic, foreign, and national security policy agencies plus those agencies that have responsibility or interest in specific issues. Thus, it has a unique capacity to address policy issues affecting a wide range of interests.

All of these interagency groups have a significant interest in barter proposals and each will want to examine the specifics of particular proposals to determine the impacts in its policy area:

- AMPSC -- strategic stockpiles
- EMPB -- emergency preparedness
- CCNRE -- materials and minerals
- TPC -- international trade
- SIG-IEP -- international economics

Each of these can make recommendations regarding particular proposals, but a final decision will have to be considered by a group encompassing all these interests. Each interested agency has cited a preference for an interagency group where it believes its interests will be best protected. Most agencies agree that an interagency group with a broad mandate and wide representation should discuss and decide on the various proposals. They agree that the SIG-IEP has that representation and could provide a fair hearing of all agencies' views in making a decision. Its advantages are as follows:

-- participation by all agencies with policy responsibilities in the areas affected by the barter;

-- representation at the Cabinet or subcabinet level; and

-- a broad mandate to address policy issues affecting international economic, foreign policy, and national security issues.

TAB A

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

July 27, 1983

MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
DIRECTOR OF CENTRAL INTELLIGENCE
UNITED STATES TRADE REPRESENTATIVE
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS

SUBJECT IG-IEP Study of Proposed Barter Arrangements

Recently several proposals have been made concerning barter arrangements involving CCC commodities and strategic materials. They have included:

- Bills introduced in Congress to broaden CCC authority to enter into barter arrangements with our foreign trading partners;
- Agency proposals to dispose of specific CCC commodities or to acquire specific strategic materials through barter;
- Foreign government proposals for bartering strategic materials for CCC commodities; and
- Private sector proposals to assist agricultural exports through barter for strategic materials.

These proposals raise several policy issues which need to be addressed, such as those affecting: (1) trade policy; (2) CCC disposal policy; and (3) strategic stockpile acquisition and funding policies.

I have asked Marc Leland to chair a meeting of the IG-IEP to review these arrangements with the intent of developing a decision memorandum for SIG-IEP consideration. He will be in contact with representatives of your agencies shortly to arrange the meeting.

Donald T. Regan

Tab B

Pending Barter Legislation and Scheduled Hearings

Bill and sponsor	Title	Precis
H.R. 1677 Wortley (R.-NY)	The Agricultural Export Equity Act of 1983	Funds from the CCC will be used for export assistance for U.S. agricultural commodities.
H.R. 2428 Evans (R.-Iowa	Amends CCC Act.	Amends CCC Act to promote the exchange of materials produced abroad and needed in the U.S. for agricultural commodities produced in the U.S. through normal commercial channels.
H.R. 3295 Evans (R.-Iowa)	Amends CCC Act.	Amends CCC Act to promote the exchange of surplus dairy stocks for other materials. Encourages barter by allowing private sector proposals to use CCC stocks.
H.R. 3544 Bennett (D.-Fla)	Amends the Stock Piling Act	Amends the Stock Piling Act to provide for surplus materials from Government agencies to be included in the stockpile, sets up barter commission and makes the transaction fund a revolving fund.
S. 822 Helms (R.-N.C.)	To expand markets for U.S. agricultural commodities	Expands the authority for the use abroad of CCC stocks, requires the sale of CCC dairy products and improves programs under P.L. 480. Amends CCC Act to require bilateral arrangements.
S. 1683 Humphrey, Symms Nickles	A bill to facilitate the efficient use of barter in managing stocks in CCC and national defense.	Allows multilateral barter, mandates use of U.S. trading firms and removes requirement that CCC be reimbursed.

S. 251 Helms (R.-N.C.)	Agricultural Export Equity Act of 1983	Amends CCC Act to require export sale of CCC dairy stocks and provides for barter of such stocks.
S. 1703 Jepsen	Exchange excess of CCC dairy stocks for materials for the strategic stockpile.	Encourages barter by allowing private sector to use CCC stocks.

Scheduled Hearings

Topic	Committee	Date
Stockpile (will include barter)	House Armed Services (Bennett (D.-Fla.))	October 19-20, 1983
Stockpile (will include barter)	Senate subcommittee on Preparedness (Humphrey R.N.H.)	November

BACKGROUND

U.S. Barter Experience

Throughout its history barter was seen as a tool to accomplish other policy objectives, and not as a primary tool to enhance overall benefits from trade. For instance, in the first decade of barter the intention was to export surplus agricultural commodities in order to avoid depressing U.S. markets. The legislative history suggests Congress intended to provide a policy guideline of encouraging exchanges of these surpluses for strategic materials, and to take advantage of spot opportunities to dispose of our agricultural glut and at the same time to fill the stockpile.

However, successful barters using either surplus CCC stocks or materials excess to the strategic stockpile to acquire needed materials for the latter are dependent on finding countries needing our excesses and which can supply commodities needed for our strategic stockpile. In other words, there must be a double coincidence of wants. Such difficulties mean compromises must be reached: we end up with materials for the stockpile which are less than high priority although we are short of them, while the supplying country may have to accept commodities which satisfy secondary needs. An illustration is the several recent barters of CCC stocks for Jamaican bauxite. While the Jamaicans would have preferred grains they had to be satisfied with NFDM, while we had to accept bauxite which, although in deficit is a lower priority compared to other deficits in the strategic stockpile. Jamaica's foreign exchange difficulties, its excess capacity in bauxite and the Administration's desire to demonstrate effective support for the Seaga government combined to outweigh pure stockpile considerations. Thus, in many, although not all, barter transactions, it is the expediency of other needs and policies for which the barter provisions of legislation governing the CCC and the strategic stockpile happen to fit and can be moulded to achieve those goals.

A variety of barter mechanisms have been authorized, most of which were used 20 years ago or more, including bilateral, multilateral and open-ended barters. The importance of each has changed over time and, depending on the mechanism used, can impact dramatically on such issues as USG treaty obligations, foreign relations, and market developments. Existing CCC law authorizes only bilateral barter agreements which do not displace cash sales. If private traders are used to complete the transaction, CCC can lose control over the final imputed prices, thus opening up the possibility of abuse of trading rules and put us in potential violation of GATT rules or in conflict with other foreign or domestic producers of the affected commodities. Also, use of private firms cannot guarantee that such barter does not replace cash sales, as is mandated by governing legislation.

CCC barters generally contain elements of export subsidies to the recipients. In the early years, the amount of the subsidy was not subject to CCC controls because third party commercial intermediaries negotiated substantially more value for the materials than they paid CCC. In the recent contracts, there is an element of subsidy since CCC has received much less than acquisition value (in terms of the acquired bauxite) for its bartered agricultural commodities.

Assessment of the impact on trade policy of past barters involving CCC commodities and stockpile materials has been virtually nil. In the several studies and reviews which have been made since the early sixties, only one devoted space to the issue of trade policy impact. In only three sentences it asserted there was a conflict between bilateral barter and U.S. trade policy -- no analysis was made. There have been only a few references to our obligations under international treaties such as GATT and how barter interacts with them. Currently, however, there is an interagency group studying U.S. countertrade policy including barter.

All the statutes governing barter contain in one way or another the following dictum: barter or exchange should be considered where it serves the national interest in terms of domestic or foreign policy goals. The interpretation of 'national interest' is subject to wide variation. In some periods, it meant using barter to dispose ~~of~~ excess CCC commodities even at the risk of subsidized prices. During the 1960's targets for materials in the stockpile changed often, resulting in fluctuating use of barter and cash sales to adjust the composition of the stockpiles. The use of CCC-stockpile barters was phased out during the late 1960's and early 1970's as the surpluses of CCC commodities were eliminated and stockpile goals were cut back.

Although much has been written on the subject of barter, there has been little analysis to date regarding its implications under the GATT. This has been in large part due to the fact that countertrade including barter was not envisaged as a problem at the time of Articles of the GATT were drawn up in the 1940's. Although the consequences of barter could be similar to the consequences of other practices which are GATT-illegal, barter itself has not been found to be illegal under the GATT. Most trade experts would say, however, that it violates the spirit of the open, market-determined, multilateral trading system sought by GATT. An ongoing interagency review of countertrade has concluded, after a review of the GATT Articles, that countertrade, if imposed by governments, runs counter to a number of fundamental GATT rules.

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Barter goods imported into the United States are subject to U.S. trade laws. The statutes providing for import relief from injurious or disruptive imports (Sections 201 and 406 of the Trade Act of 1974) can be applied to the bartered goods on the same basis as goods imported under normal commercial transactions. However, barter introduces a lack of transparency which can make it possible for a government to subsidize -- including our own government when engaged in bilateral barters such as those involving CCC and stockpile commodities -- or dump exports when such actions would not be possible through normal channels. This lack of transparency opens up the realm of abuses of trading rules by governments, including our own, thereby putting us in probable violation of GATT regulations. Antidumping and countervailing duty statutes and their applicability to countertraded goods raise a number of legal questions, which must be answered before stockpile barters and exchanges are allowed to continue.

Strategic Stockpile Organization and Policy Mechanisms

The strategic stockpile consists of almost 100 "strategic and critical" materials. It is over 30 years old. Due to changing estimates of wartime industrial needs (determined quadriennially by FEMA on the hypothesis of a 3-year conventional war), many holdings are excess to current stockpile goals, while others are deficient compared to new goals. Goals with excess commodities are valued at $5 billion while those in deficit are valued at $10 billion. PL 96-41, passed in 1979, revised basic stockpile policy law by creating a stockpile transaction fund which would receive the proceeds of sales of surplus inventories and serve as a pool of funds for buying commodities in deficit. The fund is not a revolving fund, and both disposals and acquisitions need authorizing legislation, while acquisition monies have to be appropriated from the fund. In addition to outright cash sales, the Stock Piling Act permits -- does not mandate -- the use of barter as a tool by which the GSA can dispose of excess materials and reduce the deficit materials. The GSA can use its own excess materials to exchange them directly for materials which are below goal.

Policy planning and operation of the strategic stockpile is accomplished through an interagency process authorized by PL 96-41, the Stock Piling Act, and by Executive Order 12555. Through the Executive Order, the President delegated the policy planning function to the Federal Emergency Management Agency (FEMA) and the operational functions to the General Services Administration (GSA). The policy planning and operational functions are formulated annually in the Annual Materials Plan (AMP), which is prepared by the Annual Materials Plan Steering Committee (AMPSC) an interagency staff group. The AMPSC is composed of two permanent subcommittees: Strategic Implications; and Market and International Political Impacts. In mid-1982, an ad hoc subcommittee on barter was formed. Attachment A outlines the organizational structure and member agencies.

Attachment B briefly describes the Annual Materials Plan process. Each year this process produces a list of acquisitions and disposal actions for stockpile materials. The process is initiated by FEMA, which provides to GSA a list of goals, shortfalls, excesses and the priorities for each material according to its importance to a wartime effort. After an evaluation of the market outlook, GSA proposes quantities of commodities for acquisition or disposal during the current year. These proposals are provided to the two permanent AMP subcommittees for their review. Differences between subcommittee and GSA recommendations are then resolved by the Steering Committee and submitted to the Director of FEMA for approval.

The agreed upon AMP is submitted by FEMA to the National Security Council (NSC) for its review and a copy is given to OMB for information. Any further revisions are made jointly by these three agencies. The final AMP is transmitted to the House and Senate Armed Services Committees for approval and appropriations for acquisitions.

Until early 1982, all acquisitions and disposals were made for cash. Beginning then, and as a result of Jamaica's interests in selling and bartering its bauxite to the stockpile and the existence of excess CCC dairy stocks, bartering has received increasing attention. The ad hoc subcommittee on barter of the AMPSC was established to develop lists of available CCC commodities and countries which could use these commodities in exchange for materials they could provide for the stockpile. Since last year, the subcommittee has become moribund, and barter activities of this sort have come under the direct aegis of USDA and NSC.

At first the CCC staff opposed bartering its stocks mostly because it would have to accept a GSA IOU payable several years hence. Now, they have come to accept the concept as a means of reducing burdensome and costly stocks of agricultural commodities, and USDA has urged, for example, a barter of Mexican flourspar for CCC dairy commodities. The USDA analysis of this particular opportunity showed little recognition of impacts on trade policy, treaties and relations with other nations.

This brief review shows there is no definitive, formal policy on bartering of excess CCC stocks for stockpile materials. It is a temporary coincidence that USDA and GSA are able to arrange a few barters at this time as each seeks its own objectives.

The only recent instance of a coordination of stockpile policy or operations with trade policy through the TPC mechanism was the recent FEMA request to seek a waiver from open solicitation (both

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foreign and domestic bidders) for the strategic stockpile acquisition of titanium, and to limit such acquisition to domestic suppliers. The TPC became involved because the 1979 Trade Agreements Act effectively prohibits Buy American features from commodities (and finished goods) under the jurisdiction of STR. In practice, all commodities in the strategic stockpile are under the Act's regulations and STR jurisdiction. While the titanium review was comprehensive, it addressed only this single case, and did not focus on overall policy issues and inter-relationships among affected policies.

Under Section 6 of the Stock Piling Act of 1979, disposals are to be made to domestic users to the maximum feasible extent. Any deviation from this, as in the case of tin, is generally reported to the Congress as a matter of courtesy, but not clearance. This aspect of stockpile management has not been scrutinized in terms of impacts on other policy issues such as trade, treaties and relations with other nations.

Finally, an interagency review is underway of the economic assumptions and procedures underlying the national defense stockpile goals. This examination is being done at the behest of CCEA which is in response to OMB's sharp criticism of FEMA's methods and assumptions in determining the stockpile goals. Pursuant to the review, it is expected that the economic agencies -- CEA, Treasury, and OMB will play a larger role in determining goals and overseeing stockpile management. The goals are scheduled for review this year, but completion of the process will be delayed until next year if necessary to take advantage of the interagency policy review.

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